Internal Revenue Service

memorandum

CC:TL-N-8733-88
Br4:CRGilbert

date: FEB 22 1989

to: Assistant District Counsel, [redacted] CC:[redacted]

from: Assistant Chief Counsel CC:TL
(Tax Litigation)

subject: Adjustments to return after execution of Form 870-AD
Taxpayer: [redacted]

This replies to your December 22, 1988 technical advice request regarding whether the Service may make adjustments to a taxpayer's return after execution of a Form 870-AD. We agree with your proposed conclusion that a Form 870-AD is an informal, binding settlement of the tax controversies for the subject year, and that it is Service policy to honor the agreements in a Form 870-AD even though some courts have concluded that such agreements may not be binding.

ISSUE

Whether the Service may make adjustments to a taxpayer's return where new issues are discovered by the Examination Division after execution by Appeals of a Form 870-AD for the subject year.

FACTS

The taxpayer, a mutual life insurance company, was audited for [redacted], [redacted] and [redacted]. After mutual concessions and the arrival at an agreed deficiency, a Form 870-AD was executed by the taxpayer and the Chicago Appeals Office for [redacted]. The deficiency plus interest was paid on [redacted].

The I.R.C. § 6501(a) assessment limitation period has expired for [redacted]; however, the year is still open under I.R.C. §§ 6501(h), (j) and (k), as a result of the tentative allowance of carrybacks. The amount that may still be assessed for [redacted] is limited to the amount of the carrybacks, but an assessment may relate to other issues arising that year. The executed Form 870-AD contains the standard limitations regarding reopening the tax year. The form also contains language to the effect that the deficiency findings are subject to review by the Joint Committee on Taxation on completion of the examination of the returns from which the tentatively allowed carrybacks originated, that the

findings may be adjusted in accordance with the review, that the review may require additional information, and that the carrybacks giving rise to the tentative refund may change as a result of examination of the source years.

After execution of the Form 870-AD, the Examination Division discovered [redacted] new issues for the tax year and now proposes additional adjustments of approximately $[redacted]. The issues are unrelated to the carrybacks.

DISCUSSION

Whether a Form 870-AD is a binding bilateral contract upon the parties' acceptance has been the subject of numerous cases. See Whitney v. United States, 826 F.2d 896 (9th Cir. 1987), for reference to some of these cases. In Botany Worsted Mills v. United States, 278 U.S. 282 (1929), the Supreme Court concluded that an agreement not complying with the statutory requirements for compromises cannot be binding on the Government or the taxpayer. As a result of the Botany case, the courts have nearly unanimously concluded that a Form 870-AD, by itself, is not a binding contract [emphasis added]. Nonetheless, the courts have held that equitable estoppel, if present, may cause the agreements in a Form 870-AD to have a binding effect. Guggenheim v. United States, 111 Ct. Cl. 165, 77 F.Supp. 186 (1948), cert. denied, 335 U.S. 908 (1949); Union Pacific Railroad Co. v. United States, 9 Cl. Ct. 702, 1988-1 U.S.T.C. ¶ 9357 (Fed. Cir.); Lignos v. United States, 439 F.2d 1365 (2d Cir. 1971); Elbo Coals, Inc. v. United States, 763 F.2d 818 (6th Cir. 1985).

The Service's initial litigating position was that a Form 870-AD is a binding contract upon acceptance by the parties. In 1970, however, the Service changed its position regarding this issue in A.O.D. 16949, Uinta Livestock v. United States (July 1, 1970). In the A.O.D., the Service agreed that a Form 870-AD is binding only as a result of equitable estoppel.

Substantially all of the cases dealing with a Form 870-AD have involved taxpayers seeking to reopen the subject tax year. The Government has defended those cases on equitable estoppel grounds. Here, the taxpayer will likely argue that the Government is estopped from denying the form's efficacy. In Armco, Inc. v. Commissioner, 88 T.C. 946 (1987), the Tax Court found the Service was barred from making an adjustment as a result of a previous Form 870-AD, but the court did not discuss the theory of its ruling. In an analogous case, a district court granted summary judgment against the Government, finding the taxpayer's reliance on a Form L-154, "Estate Tax Closing Letter," containing similar limitations in regard to the reopening of an estate, was both actual and detrimental. See Law v. United States, 83-1 U.S.T.C. ¶ 13,514 (N.D. CA 1982).

Traditionally, equitable estoppel is very narrowly applied against the Government. One who seeks to invoke equitable estoppel against the Government must, at a minimum, establish the four traditional elements of the doctrine: (1) that the party to be estopped was aware of the facts; (2) that the party to be estopped intended his act or omission to be acted upon; (3) that the party asserting estoppel did not have knowledge of the facts; and (4) that the party asserting estoppel reasonably relied on the conduct of the other party to his substantial injury. See Azar v. United States Postal Service, 777 F.2d 1265 (7th Cir. 1982); Portmann v. United States, 674 F.2d 1155 (7th Cir. 1981).

Since the instant taxpayer made significant concessions, including waiving its right to seek a refund, in exchange for concessions by the Service, a court may very well find the Service is estopped from later adjusting the return. Moreover, even if the Service may be able to make the newly proposed adjustments since all of the required elements of equitable estoppel are not present, we believe it is unwise for the Service to litigate contrary to its policy not to reopen mutual concession cases "unless the disposition involved fraud, malfeasance, concealment or misrepresentation of material fact, or an important mistake in mathematical calculation, and then only with the approval of the Regional Director of Appeals." See Policy Statement P-8-50 (1973).

The continued vitality of informal settlements embodied in Forms 870-AD is of substantial administrative importance to the Service. The Service has relied on the form to close thousands of cases without the delays inherent in the formalities of a closing agreement. Although these agreements lack the finality of a true contract, the Service and most taxpayers have benefitted from them and have honored them. We believe it would be imprudent for the Service to attempt to make the proposed adjustments under the facts of this case. Such adjustments could lead to litigation which could possibly engender much additional litigation. That would be unfortunate for taxpayers, for the Government, and for the courts, as the statutory and administrative procedures for formally closing tax cases are often inadequate and not flexible enough to accommodate all tax disputes that can and should be settled.

Your technical advice request indicates that you believe the form's provisions do not preclude any required Joint Committee review generated by the carrybacks, and such review may result in the adjustment of items related to the merits of the [redacted] issues, including those proposed by the Examination Division, up to the amount of the tentatively allowed carrybacks. We note that even though a Form 870-AD is not a binding contract it is an agreement subject to the rules of contractual interpretation. See Flynn v.

United States, 786 F.2d 586 (3d Cir. 1986); Estate of Craft v. Commissioner, 68 T.C. 249 (1977), aff'd per curiam, 608 F.2d 240 (5th Cir. 1979).

In our opinion, it is unclear whether the Joint Committee may adjust issues which are unrelated to the carrybacks, including the [redacted] issues raised by the Examination Division but not addressed in the Form 870-AD. The form's provisions allow for Joint Committee adjustment of the agreed findings to give effect to the Committee's determinations regarding the tentatively allowed carrybacks. Yet, since the taxpayer has paid a deficiency for [redacted], it appears the issues arising that year would themselves not be subject to Joint Committee review under I.R.C. § 6405. In any event, we agree with you that the Service should not seek to reopen the year unless one of the specifically enumerated exceptions is met, and that it is unlikely that the Joint Committee review will reach the new issues raised by the Examination Division.

We have informally coordinated our reply with the office of the National Director of Appeals, and they have expressed their agreement with our conclusions. If you have any questions regarding this matter, please contact Craig R. Gilbert at FTS 566-3305.

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By: _____
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